

# Memorandum

To : White & Case / Attn. Mr Frank Panopoulos  
From : Philippe Dupont / Grégory Minne  
Date : 7 January 2011  
Subject : Entitlement to securities held with Clearstream Banking  
Your references : /  
Our references : 37538-4754788

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## Introduction

1. You request our advice with respect to the entitlement of Bank Markazi against Clearstream Banking S.A. ( **Clearstream**) regarding securities ( **Securities**) credited to an account held with Clearstream in Luxembourg and sub-deposited by Clearstream in its name with Citibank in New York (I.), the place of performance of Clearstream's obligations to hold and return the Securities (II.), and the law applicable to the entitlement of Bank Markazi to the Securities (III.).
2. This memorandum is limited to the matters stated herein and does not extend, and is not to be read as extending by implication, to any other matters. It is based exclusively on, and relates solely to matters of, Luxembourg law, including its rules on conflicts of laws, in force at the date hereof and assume that no foreign laws will have any bearing on it.
3. Luxembourg legal concepts are expressed in English terms and not in their original French terms. The concepts concerned may not be identical to the concepts described by the same English terms as they exist in the laws of other jurisdictions. This memorandum may, therefore, only be relied on upon the express condition that any issues of the interpretation or liability arising thereunder will be governed by Luxembourg Law and be brought before a court in Luxembourg.

## I. Clearstream's obligations under the account agreement with Bank Markazi

4. Clearstream's obligations under its account agreement with Bank Markazi are limited in nature to clearance, settlement, custodial, administrative and other ancillary services, as provided by the general terms & conditions governing the relationship between Clearstream and Bank Markazi. As custodian Clearstream does not acquire any proprietary rights in the Securities deposited with it by Bank Markazi. Under its obligations as custodian, Clearstream can, under Luxembourg law, only transfer entitlements booked in its customer's account upon the latter's instructions.

## II. Entitlement of Bank Markazi to the Securities

5. Securities held in a securities account with Clearstream and which are transferrable by book entries are considered under Luxembourg law to be fungible securities.
6. From a traditional civil law point of view, the deposit of fungible goods is characterized as an irregular deposit ( *depôt irrégulier*). Under ordinary principles of civil law the custodian becomes the legal owner of the fungible goods deposited with it.

Accordingly, depositors are only entitled to a personal claim (*droit personnel*) against the custodian.

7. The Luxembourg legislature has, however, created a specific regime for deposits of fungible securities by a Grand Ducal regulation of 17 February 1971 which has been replaced by the Luxembourg law of 1<sup>st</sup> August 2001 on the circulation of securities and other fungible instruments, as amended (the **Securities Act**)<sup>1</sup>.
8. There is no exhaustive list of all the types of financial instruments to which the Securities Act applies. The Luxembourg legislature has adopted a pragmatic approach which is to provide for a definition which potentially encloses any new financial instrument created by the financial markets and which may be credited to a securities account and transferred by book entry.

The Securities Act thus applies to securities within the broadest possible sense which are deposited or held in an account with a custodian and which are fungible<sup>2</sup>, whether they are materialized or dematerialized, in bearer form, to the order of or in registered form, subject to Luxembourg law or a foreign law, and irrespective of the form in which they have been issued under their governing law. Entitlements to securities held in a securities account with Clearstream are thus governed by the Securities Act.

9. The Securities Act provides a protective measure in favor of depositors of fungible securities which consists in granting a right *in rem* to depositors. As a derogation to general civil law principles, the custodian of fungible securities does not become the owner thereof.

The depositor has the same entitlement to the securities as if the securities had remained with it<sup>3</sup>. The entitlement of depositors is characterized as right *in rem* of an intangible nature (*droit réel de nature incorporelle*), up to the number of securities booked to their accounts, on the entirety of the securities of the same kind deposited with or held in an account by the custodian<sup>4</sup> i.e. Clearstream.

Such right *in rem* can pursuant to Article 6 of the Securities Act only be exercised by the depositor against its custodian<sup>5</sup> even if its custodian (here Clearstream) has sub-deposited the Securities with a higher tier intermediary. There is only one exception to this general rule: in case of bankruptcy of its custodian the depositor acquires a direct right against the sub-custodian of its custodian. Since Clearstream is not bankrupt this exception does not apply.

10. In summary, where Bank Markazi holds a securities account with Clearstream it has a right *in rem* of an intangible nature on the Securities held in its account, but it may exercise its entitlement to the Securities only against Clearstream. Luxembourg law denies any rights to Bank Markazi to exercise any rights to the Securities against Citibank with which Clearstream has sub-deposited the Securities in its name.

<sup>1</sup> Loi du 1<sup>er</sup> août 2001 concernant la circulation de titres et d'autres instruments fungibles (Mémorial A, 2001, p.2180) as amended by Loi du 5 août 2005 sur les contrats de garantie financière (Mémorial A, 2005, p.2212). The provisions of the Luxembourg Civil Code continue to apply unless the Securities Act departs from such provisions.

<sup>2</sup> Securities received on deposit or held in an account with a custodian without indication of numbers or other individual identification elements are deemed to be fungible (Article 1 § 2 of the Securities Act).

<sup>3</sup> Article 6 §1 of the Securities Act.

<sup>4</sup> Article 6 §2 of the Securities Act.

<sup>5</sup> Article 6 §3 of the Securities Act.

### **III. Place of performance of Clearstream's obligations with respect to Bank Markazi's entitlements**

11. As mentioned in section I above, under the Securities Act, the entitlement to securities deposited with a custodian can only be enforced by the depositor against such custodian<sup>6</sup>.
12. From a conflict of laws perspective, it is traditionally held that a bank is the obligor of the characteristic performance with respect to the services rendered to its clients<sup>7</sup>.
13. According to Luxembourg case law<sup>8</sup>, the characteristic performance in bilateral agreements is that of the party who performs the obligation in consideration of the money paid for such performance.
14. Based on the foregoing, we are of the view that under Luxembourg law the place where Clearstream must perform its obligations with respect to Bank Markazi's entitlements is Luxembourg, not New York.
15. The parties have expressly confirmed this analysis resulting from the law in providing contractually in article 61 of the General Terms and Conditions of Clearstream that: "These General Terms and Conditions shall be governed and construed in accordance with the laws of the Grand Duchy of Luxembourg. Matters not expressly provided for in these General Terms and Conditions shall be governed by the applicable provisions of Luxembourg law. The Customer will submit to the non-exclusive jurisdiction of the competent Luxembourg courts for any litigation which may arise."
16. Irrespective of any choice of forum clause, under Luxembourg law, Bank Markazi cannot enforce its proprietary rights against Clearstream in New York, but must do so in Luxembourg, Luxembourg being the place where its securities account is held and the place of performance under its account agreement with Clearstream<sup>9</sup>.

### **IV. Place of location of Clearstream's obligations with respect to Bank Markazi's entitlements**

17. Under the Securities Act<sup>10</sup>, a custodian is entitled to sub-deposit securities remitted or transferred to an account held with such custodian with other custodians located in Luxembourg or abroad.

The custodian must ensure that such securities be held separately from its own securities with such other custodians. Pursuant to Article 12 of the Securities Act

<sup>6</sup> Article 6 §3 of the Securities Act.

<sup>7</sup> F. SCHOCKWEILER, *Les conflits de lois et les conflits de juridictions en droit international privé luxembourgeois*, 2<sup>nd</sup> ed., Paul Bauler, s.d., n° 510; A.-C. VAN GYSEL/J. INGBER « A la recherche de la prestation caractéristique », *Rev. Dr. ULB*, 1994, p. 92-93.

<sup>8</sup> Court of Appeal, 23 May 2001, cause number 20289; Court of Appeal, 2 March 2000, *Pas.* 31, p. 274 ff.; Court of Appeal, 20 June 1995, cause number 16 651; Court of Appeal, 10 May 1994, cause number 15 664; Luxembourg District Court, 1 June 2005, cause number 91269; Luxembourg District Court, 27 February 2003, cause number 47586; Luxembourg District Court, 10 July 2002, cause number 75629; Luxembourg District Court, 20 July 2001, cause number 49020.

<sup>9</sup> Article 2, Article 5 (1) and Article 23 of the Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters; H. Gaudemet-Tallon, *Compétence et exécution des jugements en Europe*, 4e éd., LGDJ, 2010, p.159 ff.

<sup>10</sup> Article 12 of the Securities Act.

“neither the applicability of the law nor the location of the securities, which shall be deemed to remain with the custodian, shall be affected by such sub-deposit.”

18. According to the parliamentary works<sup>11</sup> of the Securities Act<sup>12</sup>, Luxembourg law applies the traditional conflict of laws rule on proprietary law aspects (i.e. *lex rei sitae*<sup>13</sup>). Luxembourg law assumes that book-entry securities held with a custodian are located at the place of the registered office (*siège social*) or the principal place of business (*siège d’exploitation*) of such custodian, even if these securities are sub-deposited abroad by such custodian. This rule is supported by the fungible nature of the securities held with the custodian and the intangible nature of the right of the depositor. Since the right of the depositor can be exercised against the custodian only, such right is governed by Luxembourg law since the account where the securities are credited on behalf of the depositor is located in Luxembourg. Accordingly, Luxembourg law governs the entitlements of Bank Markazi to the Securities held in its securities account with Clearstream, irrespective of the fact that Clearstream has sub-deposited certain US securities with Citibank.
19. Based on the foregoing, we are of the view that under Luxembourg law the entitlement of Bank Markazi is governed by Luxembourg law.

#### IV. Bank Markazi may exercise its voting rights against the issuer

20. We have reviewed footnote 16 of Plaintiffs’ Opposition Memorandum dated November 11, 2010, in which Plaintiffs refer to the European Commission, EU Clearing and Settlement Legal Certainty Group Questionnaire (Apr. 24, 2006) (the **Questionnaire**), to argue that Bank Markazi can enforce rights in the securities against upper tier intermediaries. Plaintiffs misinterpret the Questionnaire, as they:
  - confuse the rights *in rem* to the securities exercisable against the intermediary with the rights “attached” to the securities exercisable against the issuer,
  - and wrongly argue that the rights *in rem* to the securities may be enforced against upper tier intermediaries.

The authors of this Memorandum are quite familiar with the Questionnaire as they are the authors of the Luxembourg responses to the Questionnaire.

21. The Securities Act distinguishes between the rights *in rem* to the securities and the rights “attached” to the securities. The latter are the corporate and contractual rights attached to the securities.

The Questionnaire expressly addresses this distinction in its question no. 9 which reads as follows: “is there any distinction between (i) the rights arising out of the securities against the issuer and (ii) the rights in respect of holding the security?”.

The response to this question in relation to Luxembourg law contained in the Questionnaire is the following:

<sup>11</sup> The parliamentary works are the various preparatory documents leading to the vote of a law and include i.a. the draft version(s) of the relevant law and comments by various institutions including the government and the state council on the draft law. The parliamentary works are an important source used by courts to determine the intention of the legislature when courts need to interpret the provisions of a law.

<sup>12</sup> Doc. Parl. N° 4695, 29 September 2000, p. 9.

<sup>13</sup> Also named *lex situs*.

"The Securities Act clearly distinguishes between the rights arising out of the securities against the issuer and the rights in respect of the holding of the securities.

(i) [...] The rights arising out of the securities may be exercised following the procedures established by the Securities Act:

Article 8: "The rights attached to securities and other financial instruments may be exercised by means of the production of a certificate, set up for the purposes set out therein, by the depository certifying the number of securities or other financial instruments booked to the account.

For the purposes of participating in a general meeting of a company, the numerical list of securities or other financial instruments booked to an account with a depository may validly be replaced by a certificate delivered by such depository to the depositor which confirms the unavailability of the securities or other financial instruments booked to the account up to the date of the general meeting".

(ii) As to the rights in respect of the holding of the securities, the depositor has a right *in rem* of an intangible nature, a right of co-ownership in an intangible pool of book-entry securities. The depositor can only exercise this right *in rem* against the depository (Art. 6 of the Securities Act)."

22. In relation to rights "attached" to securities, the Questionnaire accordingly also indicates in relation to Luxembourg law in its paragraph 12.14. that "Pursuant to Article 8 of the Securities Act, the investor can directly assert the rights attached to the securities (economical and non-economical rights) against the issuer including in case of insolvency of the latter (e.g. to vote in its winding-up) by means of the production of a certificate issued by the depository certifying the number of securities booked to the securities account." Economical and non-economical rights cover mainly voting rights and contractual rights against the issuer.

The rights attached to the securities may thus be exercised directly by the investor against the issuer (not against upper tier intermediaries).

23. However, the rights to the securities may only be exercised by the depositor against its custodian as expressly set out in Article 6 of the Securities Act.

Again, the Questionnaire confirms in its paragraph 7.14. that unless the custodian is insolvent, no rights to the securities may be exercised by the depositor against the sub-custodian of the relevant securities: "It is to be noted that, unless the depository is declared bankrupt, such right *in rem* can only be enforced by the investor (depositor) against its direct depository (Art. 6 of the Securities Act)".

The Questionnaire also confirms this point in its paragraph 12.14.: "The investor's co-ownership rights are directly enforceable only against the intermediary maintaining the securities account".

24. We also would like to point out that, as a response to question 26 (Can the investor enforce rights against an upper-tier intermediary (i) normally, (ii) in the event of breach of duty by the intermediary, (iii) in the event of breach of duty by the upper-tier

intermediary, (iv) if the event is insolvency rather than breach of duty?) the Questionnaire provides in relation to Luxembourg law that “under the Securities Act, accountholders do not have direct rights against upper-tier intermediaries appointed by their intermediary, subject however to the direct right of recovery of clients of such intermediary in event of the latter’s insolvency (cf answer to question 15)”.

Also, the Luxembourg law response to the question 27 “in what circumstances can (i) a creditor and (ii) a non-creditor third party (such as a liquidator) of the investor claim securities from an upper-tier intermediary?” is the following: “unless in the event of insolvency of the intermediary, an investor and a fortiori a creditor and a non-creditor third party of the investor, may not claim any securities from an upper-tier intermediary. Furthermore, to the extent that the upper-tier intermediary is a securities settlement system and in accordance with Article 15 of the Securities Act, attachments of securities accounts opened with a settlement institution are not permitted”.

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